The Canadian Chartered Accountant

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

[DE]CEMBER [1]949

$5.00 A YEAR - 50c A COPY

Merry Christmas

The Canadian
Chartered Accountant

VOLUME 55 DECEMBER 1949 NUMBER 6

PUBLISHED MONTHLY

By The Dominion Association of Chartered Accountants

R. F. Bruce Taylor, F.C.A., *Chairman, Editorial Committee*

Editorial and Business Offices, 10 Adelaide Street East, Toronto, Ontario

Melville Pierce, *Managing Editor* Jean Vale, *Assistant Editor*

Subscriptions to *The Canadian Chartered Accountant* and *The Tax Review*: $5.00 a year. Additional subscriptions to *The Tax Review*: $3.00 a year.

Single copies (including *The Tax Review*) 50c. Single copies of *The Tax Review* 25c.

A volume index to *The Canadian Chartered Accountant* is published semi-annually and to *The Tax Review* annually.

Opinions expressed in articles and comment are not necessarily endorsed by The Dominion Association of Chartered Accountants.

Advertising rates on request

Authorized as second class mail by the Post Office Department, Ottawa

The Canadian
Chartered Accountant

VOLUME 55 DECEMBER 1949 NUMBER 6

A Christmas Message from the President

IT IS A VERY HAPPY privilege to extend to you through the medium of *The Canadian Chartered Accountant* my most sincere wish for all those things which will bring to you peace, health and happiness in the Christmas season, and to wish for you a substantial measure of fulfilment of all your hopes for the New Year.

This is the time of year when we all find ourselves placing the human and spiritual ahead of the material things of life, when we all in our own personal way pause to pay tribute to the memory of a Man who, more than nineteen hundred years ago, gave us a sample of a truly balanced life. The uncertainties in the year ahead and our constant fear that any day we may again be involved in war should prompt us to pause more often to pay humble and reverential homage to Him Whose birthday we celebrate at Christmas, and to make the spirit of "Peace on earth, good will to men" an essential part of our own lives, not only at Christmas, but throughout the entire year.

During the past few months I have had an opportunity to meet a great many of the members of our profession in Canada, and in that meeting to learn to know each of them a little better. It leaves with me the impression that this Christmas message is a very personal one, and with that thought in mind, I extend to you all my very best wishes for a most enjoyable and happy Christmas season and a New Year rich with the joys of peace, happiness, and goodwill.

H. R. DOANE
President, The Dominion Association of Chartered Accountants

COMMENT AND OPINION

New Products

WHETHER or not a pun was intended we do not know, but *Saturday Night* of November 15 uses this heading to cover the following note—

> New Yorkers who have trouble with multiplication are getting a break. A firm is offering a chart for office workers enabling them to multiply any two numbers by copying figures from a chart and adding them.

This sounds to us suspiciously like a logarithmic table on which we imagine all patents expired years ago; and it reminds us that most of us are not at all familiar with a slide rule, which is faster than any calculating machine when using numbers of three or four digits. Beyond this number it will not be precise, but in computing percentages, it will bring out the nearest tenth which is close enough for most of us.

We owned at one time, but lost, a cylindrical slide rule which could be read to greater accuracy than the conventional ruler type. It was given to us by the inventor, but we never saw it made available for sale to the public.

The break referred to is therefore not reserved for New Yorkers and is available to any one of us who wishes to purchase a volume of logarithm tables or a slide rule. As a further boost for this mathematical procedure, we remind our readers that the tables also provide in equally simple ways short cuts for division as well as multiplication. In fact, the only arithmetical problems one cannot solve with logarithms are the simple ones of addition and subtraction. One thing *Saturday Night* omits to mention is that, having added the figures, the table must be referred to again to ascertain the product of the two numbers. The accuracy of the result is always limited by the number of digits shown in the tables. We occasionally use a *Chambers' Tables of Logarithms* which are seven-figure tables. Most standard tables are correct to four figures only.

It is our recollection that there is no purely arithmetical way in which to solve $x\sqrt{y}$ where x is larger than 2. With this "new product" it is simply necessary to divide the logarithm of y by the logarithm of x and refer back to the table to find the number representing the logarithm of the quotient.

Things We Doubt Were Ever Said

SOME of our readers will recognize this phrase, a favorite of *The New Yorker,* a magazine which no editor should ever be without. We are reminded of this heading from an extraordinary opening sentence in a letter to the editor of *The Journal of Accountancy* which is contained in its November 1949 issue. We do not fit the heading to the case because the sentence is in the Journal and therefore must have been written to it. Equally, we are quite sure that the writer of the letter no doubt did what he said he did. If we could ever have anyone do that to our own publication, we should indeed nail a flag to our masthead.

The sentence reads: "While waiting for a train in Youngstown, Ohio, I stopped in at the Public Library to read the Journal". We have seen *The Canadian Chartered Accountant* read in streetcars, busses and trains but never in a public library. At another place in the Journal, it tells us that its circulation is 100% a paid circulation. *The Canada Year Book* does not tell us how many people wait for trains in Canada, but there are some thousands of public libraries. We bring

this to the attention of our circulation department. Incidentally, how many of our readers would go out of their way to look for this magazine while waiting for a train? Shame on you; our neighbours to the South take a great deal more interest in things professional than you do. Let us give them all credit for the deserving conduct of one.

Nerves

FOR the first time in his lifetime, the writer of this comment is suffering from nerves. For the first time in his business lifetime, he has had to set up and write up accounts, and they are now in the hands of the auditors. The books and records were taken away two weeks ago and nothing has been heard of them since, except that the two appointed auditors have already spent two evenings on them until after one o'clock. We lie awake at nights wondering what could be wrong and why at least one telephone call has not been made requesting information.

The accounts are of a Boy Scout summer camp, which ran from July 1st until Labour Day. There were 81 cheques issued, each signed by the writer and another member of the executive committee. Deposits were made over the period from April to August and aggregated some $7,000. According to the reckoning there was something over $500 left at the end of the season which was promptly turned over to the treasurer of the group committee.

There were no real "plugs"; just a couple of entries were somewhat forced in order to do something with overages in the leaders' petty cash reports which resulted from their using "Tuck Shop" money occasionally if it was closer to them when milk and other supplies were delivered. There is nothing that should cause the auditors any concern.

But what are they doing in the house a few blocks away? Are they scratching their heads and thinking terrible things? Or are they swapping stories part of the time and soldiering on the job? Are they going to run to the chairman without speaking to us first? What can the matter be and how long do we have to live in doubt?

Our working papers were as we had been taught auditors would require. Every expense account was analyzed. The vouchers were all complete except for some $8 of postage which we advanced from time to time without keeping any record. Could that be causing trouble? We did make a mistake when writing one cheque and we threw it in the wastepaper basket. That should be all right, because fortunately it did not carry a printed number. We wonder if some spy kept a record of the meals we had at the camp one weekend for which the leader would not let us pay the regular tariff. Could that be it?

If there is no Comment and Opinion in the next issue, you will know that we are a nervous wreck. Why must there be auditors anyway? What good do they do? And why don't they get on with the job and leave us in peace to attend to our important daily tasks? Shall we ever be able to look them in the eyes again and not wonder what they think of our accounting ability and technique? Before we gave the accounts to them, we were asked to do the camp job again next year. Should we refuse unless some restrictions are placed on the auditors? Do we have to live again through troubled weeks such as these? It must be wonderful to be an auditor and have no regard for the treasurer's feelings. Oh, to be an auditor! — all he has to do is criticize. And if he puts ink smudges on our ledger, which we forgot to charge for, we'll murder him.

What a Banker Looks For In Accountants' Financial Statements

By A. C. Ashforth
(General Manager, The Dominion Bank)

Banks are the greatest users of the accountants' "products"

THE attributes and qualities which make up a chartered accountant are, in my opinion, similar to those found in a banker. We are by nature conservative (not necessarily politically), dependable and without flare for the spotlight. Furthermore, I believe the banks are the greatest users of a chartered accountant's "products" because no banker can properly assess a credit risk without the benefit of an audited statement. My remarks not only have reference to published statements, but apply particularly to those audited statements which are placed in the hands of a bank.

Balance Sheets: What a Banker Looks For

Balance sheets are simply a combination of recorded facts and opinions summarizing in figures the financial state of affairs at a stated time. To a banker certain inferences are deduced from the figures which, when compared with the previous year's statement of a company, enable him to judge whether it is progressing or going behind. It is needless for me to say that banks depend immeasurably upon the accuracy of audited statements and the judgment exercised by the auditor in their preparation.

In examining balance sheets, the banker's first observations are directed to the liquid position, i.e., the ratio of current assets to liabilities. This gives the best indication of the credit worthiness of a company. It is important, therefore, that every item included in liquid assets be carefully scrutinized and properly assessed as such.

It is appreciated that there are various types of audit, from a balance sheet to a continuous running audit. No doubt the extent of the work performed by the auditor depends upon the arrangement with his client and this, in a large measure, is probably governed by the nature of the business and the efficiency of the accounting methods. The happy medium, I suppose, is somewhere between the two and it is left to the third party to determine from the auditor's report the extent of the examinations and tests that have been made to adequately disclose the position of the company, and I would be bold enough to comment upon one or two features in this connection.

A bank, in analyzing a balance sheet, desires to find in the auditor's report the necessary assurance that it is a correct and accurate picture of the financial position of the business. In many instances no comment is made — merely the usual form of certification. In my

A paper read at the 47th annual meeting of the D.A.C.A., Toronto, Sept. 14

opinion, suitable explanations should be given regarding various assets and liabilities whenever circumstances warrant it. Too frequently we have to approach the auditor or our customer for the information.

Inventory Valuations

I venture to suggest that inventory valuations are the crucial feature in the compilation of the balance sheet, also the operating results for the year. As you will realize, there has been in recent years a tendency to be ultra-conservative in the pricing of inventory, and, with few exceptions, determining values has not presented any difficulty from a lending point of view. The situation is now changing and the inventory, its composition and the value placed up it, again looms very large in appraising the worth of a business and the operating results.

The subdivision of inventories into those recognized classifications in the case of manufacturing accounts is very desirable, that is, manufactured goods, goods in process and raw materials. In some cases there is a fourth classification — supplies. These embrace all manner of items from containers down to janitors' supplies. What place they have in the current assets of the business is something that has to be left to the judgment of those responsible for compiling the balance sheet, but I would think that any large amount under this category is deserving of separate notation — although I have not infrequently found it included with stock-on-hand.

The difficulty that an auditor encounters in determining inventory values is fully realized, and particularly so in the case of a business which may be spread over the whole of the country or a large part of it. On the other hand, information as to the method in which inventory valuation has been compiled — with reasonable assurance by tests that the procedure has been followed, that prices are not out of line, with impurities removed, or allowed for in the way of obsolete, shopworn and otherwise deteriorated stocks — would be an indication to those looking over an audited statement that this important item has received the attention it deserves. Limiting the remarks to bare statement that the inventory is in accordance with the certificate furnished by the officers of the company is not convincing as being an outward expression of an independent consideration as to the value placed on the asset in the balance sheet. Could not this rather negative approach to the question of verification be changed to a positive statement? I should think that the great majority of inventories are subject to test check without too much difficulty. For the remainder, a positive statement could be made that, while prices and arithmetical computations have been reviewed, it was not practicable for the auditors to verify quality or chemical content due to the type of materials involved.

Forward Purchase Commitments

It is, I gather, a debatable question as to whether the statement should disclose forward purchase commitments on firm contracts. I have no doubt that it is something which is carefully inquired into during the course of an audit. Knowing that it is the policy not to omit any information which, if disclosed, would materially alter the impression created by the statement, I am encouraged to believe that any substantial commitments of this kind at prices which, because of a falling market, could prove embarrassing to the business, would be the subject of comment. However, quite apart from the question of prices, it can frequently be very useful when considering a credit authorization to know whether the prospective borrower has any exceptionally heavy commitments outstanding.

Accounts Receivable

Accounts receivable, like inventory, are once again showing signs of requiring careful survey to assess their real worth. Bad debt losses have not been, generally speaking, important during recent years — I suppose because debtors who did not pay, and pay promptly, did not get any more credit and they knew it. With business more competitive as goods get into more plentiful supply, we find that this can become apparent in the credit risks. For this reason we should like to see the gross amounts of receivables and reserves for bad debts shown on the balance sheet. Banks frequently make loans on the security of assigned receivables and the auditor's estimate of the reserve required at the balance sheet date provides a useful guide to our own valuation of current receivables.

Liabilities

In dealing with the liabilities, the assurance that every possible safeguard has been followed to see that all of them are included is no doubt implied even though the only reference in the report may be that a certificate has been obtained from responsible officers to this effect. I suppose that all the Companies Acts require that secured debts be shown separately from unsecured debts. The Dominion *Companies Act* specifically states, "It shall not be necessary to specify in the balance sheet the assets on which the liability is secured", but this is information which a banker must have and some reference in the auditor's report would be helpful.

Some Suggestions

I have been told that diplomacy is to do and say the nastiest things in the nicest way.

I know it is true the Companies Acts, in varying degrees, indicate the manner in which receivables are to be classified in the balance sheet; however, may I respectfully suggest the following for your consideration:

(*a*) Receivables emanating from the sale of goods should be described in the balance sheet as "trade receivables" and other receivables should be accurately described under suitable headings.

(*b*) Regarding "trade receivables", in my opinion it is not necessary to set up in the balance sheet separate headings — accounts receivable, bills receivable, accounts and bills receivable — but merely "receivables — trade".

(*c*) Where a company borrows from the bank against an assignment of book debts, the aging of receivables (30-60-90 days or longer) is important. Although we realize that different types of business sell on varying terms, due allowance for this is made by the bank.

(*d*) I am of the opinion that all overdue accounts receivable should be confirmed by the auditor, bringing to light any claims which might be under dispute. In many cases audit firms itemize all accounts receivable where the list is not too lengthy, or show separately those over a stated amount. Likewise accounts payable are shown. This information is helpful and enables the bank to appraise the risk and ascertain whether any of the accounts so shown may be subject to *contra* claims.

(*e*) I like to see various depreciation reserve accounts deducted from the specific asset. Such reserves are frequently shown on the liability side of the balance sheet.

Depreciation presents a very difficult problem to-day, or rather the adequacy of the reserve, due to increased costs; in other words, to replace a machine or a building will probably cost a great deal more than did the original machine or building.

I do not know whether this is in the realm of accountancy or not, but if a business is faced with a substantial ex-

penditure to replace a worn-out machine or equipment, involving a substantial outlay, in order to maintain operations at a proper degree of efficiency, it is information which a banker should have. You will realize how serious this could be should the liquid position not adequately reflect a proper bookkeeping reserve for present or future cost of replacement.

(*f*) I like to see trade paper under discount included with receivables, and the relative bank indebtedness shown as a liability rather than show paper under discount as a contingent liability.

(*g*) We like to have a reconciliation of the changes occurring during the year in the liquid surplus of a company. For our own purposes, we always prepare such a reconciliation but only a few audit reports include this information, although I am pleased to see a growing tendency to give this data in your reports.

(*h*) The position relating to income taxes paid during the year, and the amounts accrued and owing, should always be set out clearly.

(*i*) In the case of a private company the auditor's report should show the amounts of salaries paid to the principals. It has been stated that in some cases all or a portion of executives' salaries have been included under such headings as "selling expenses" and "office salaries", etc. It is of importance to the bank to know to what extent the principals have benefited from operations during the year by way of salaries, bonuses, etc.

(*j*) Regarding shareholdings — in the case of companies whose shares are closely held, it is desirable to list the shareholdings.

(*k*) Investments in subsidiary or associate companies should not be classified as a current asset unless the liquid surplus in the subsidiary or associate company justifies it being so classified. Of course loans to, or from, subsidiary or associate companies should be shown separately from the share investment.

(*l*) If goods are acquired on a consignment basis, an explanation should be given.

(*m*) In the division between active and inactive assets, I have noticed some differences in balance sheets. I have, for instance, seen amounts owing by officers of a company classified as current assets when there was no apparent intention, much less apparent ability, to pay them. I have also seen prepaid expenses put in the same category.

In the liabilities I do like the practice of showing as a current obligation instalments due during the 12 months period of long-term liabilities.

Uniform Company Law Desirable

After glancing over three of the Companies Acts, and I suppose there are eleven of them when you include Newfoundland, I am constrained to make this observation:—

Would it be possible to promote the further study of the question of *uniform company law* by say the "Conference of Commissioners on Uniformity of Legislation in Canada"?

I say further study of the subject because I suspect some consideration has already been given to the matter and it may have bogged down somewhere. If *uniformity* could at least be achieved in the setting up of balance sheets it would be worthwhile. Even though this suggestion relates to limited companies, they comprise the larger part of our business organizations and probably set the pattern for others in this respect.

Continual Exploration

Apart from the foregoing, I find it rather difficult to advance any concrete suggestions which might improve the services performed by chartered accountants. Accountants, like everyone else, must constantly be exploring every avenue for

the improving and simplifying of accounting procedure to keep step with changing business conditions. This they have done well and I suppose that in no phase of accounting is this more pronounced than in the problems arising from taxation. I, however, do not view this as the most important phase of their work. The training and experience of accountants is more and more being utilized in dealing with business problems.

With any deterioration in business it necessarily follows that some customers of accountants and banks, shall feel the effects of it. I presume you know, as do we, those companies whose finances are strained, and we respectfully urge accountants to assist them and us by preparing their statements as soon as possible after the close of their fiscal year. It has been said that "Happiness is beneficial for the body, but it is grief that develops the powers of the mind". If that is true, you can sharpen your wits by directing a little more attention to those deserving clients.

SO'S YOUR OLD GRAMMAR, OR THE CLIENT ALWAYS PAYS

A drama in three acts by Pongo Jones, a modest playwright whose masterpiece was submitted by Mr Howard I. Ross, C.A.

ACT 1

Scene: The general offices of Smithkins Manufacturing Co., a valued client of Messrs. Locke, Stock, Baril and McFetrick, Chartered Accountants. As the curtain rises, Jim Crowe, a very junior member of the auditing staff, is approaching the desk at which his immediate boss, Simon Waggle, C.A., is working. Crowe carries a large book under his arm.

CROWE: Well I've finished adding this here ledger. It's O.K.

WAGGLE: That's fine, but, Jim — you might as well learn these things as you go — we don't think much of this "this here" business. As you get on, I think you will find it pays to be a little careful about such things, unless, of course, you intend to practise out in Alberta* or somewhere like that.

ACT 2

Some days later

Scene: The private office of C. A. McFetrick, C.A., a partner in the firm of Locke, Stock, Baril and McFetrick. Simon Waggle is discovered going over working papers with Mr. McFetrick.

WAGGLE: Then we reviewed the reserve and concluded that it was adequate under the circumstances.

MCFETRICK: Quite so, but . . . (*he pauses in deep thought, obviously makes a decision and then proceeds slowly*) . . . I trust you will not mind my drawing the point to your attention, Waggle, but circumstances are clearly things that stand around. I think it follows that whatever they stand around is "in" them rather than "under" them. Unhappily, the phrase "under the circumstances" is gaining some currency but I must confess that it is a solecism that I find a little upsetting.

WAGGLE (*abashed*): I'm afraid I was not thinking, sir.

(*The curtain falls as Waggle pauses, clearly making a mental note*).

ACT 3

Some weeks later

Scene: The private office of Murdo Smithkins, owner of Smithkins Manufacturing Co. Mr. McFetrick has just arrived to deliver and "go over" the financial statements of the company with Mr. Smithkins.

MCFETRICK (*ingratiatingly*): It is extremely gratifying, Mr. Simpkins, to see that you have had such a splendid year.

SMITHKINS: Yeah, I guess we done pretty good at that, eh?

MCFETRICK (*bravely*): Yes, you certainly done very good indeed.

Curtain

*Or B.C., Ont., Sask., Que., Man., N.S., N.B., P.E.I. or Nfld. as the case may be.

Building Goodwill With Financial Reports

By J. William Horsey
(President, Dominion Stores Ltd.)

Financial statements should be directed not only to the shareholders, but to customers, employees and suppliers as well

ALL HUMAN relationships are good, bad, or passive. Good relationships are the result of positive planning and development. They are, as a matter of fact, a positive force and should be recognized as such. Such expressions as: "He is just naturally a good guy—everybody likes him", "He makes friends by the million with no effort at all", are as great fallacies as "He's a born salesman", particularly if you have in mind convincing two or three million consumers that your organization is a "good guy". You will pardon me, I am sure, if I draw some of my examples and illustrations from the history of Dominion Stores. It is my backyard and I should know every inch of ground.

The Measure of Success

Ten years ago we recognized a fundamental fact, viz., that the measure of our progress and development would be our customer relations. We did not have a good name. We were *considered* tough buyers, poor wage payers, greedy, and (in spite of rendering a useful service to consumers generally in goods and fair prices) we were in the game only to make money. This was most serious and in a public statement to our own people and our shareholders I said that we could not consider ourselves successful until Dominion Stores Limited was considered a good thing — good for producers, processors and manufacturers, good for those who invested their money to make the company possible, good for those who earn their livelihood within its activities, good for consumers whose purchases sustain the operation, and good for our country. This truth became of paramount importance — "No company's public relations will ever exceed the company's policy". This is a basic concept in all our thinking and planning. Out of this was born our expressed "Aim", to wit:

> The aim of Dominion Stores Limited is to fulfil with ever-increasing efficiency its responsibility as a distributor of food, thereby performing a satisfactory service to the consumer, producer, manufacturer and processor; to discharge its responsibility to shareholders whose investment makes the company possible; and to provide its employees with a satisfactory living under the best possible conditions.

We believed, and still believe, that we should think of ourselves as builders erecting in the broad fields of the food industry an enduring edifice of which our *aim* is the blueprint.

A paper read at the 47th annual meeting of the D.A.C.A., Toronto, Sept. 14

Crying Need of Business

The crying need in many aspects of business today is for a merchandising concept. A great Canadian industrialist said to me recently, "What we need is more merchandisers in business, but there are very few of them left".

Annual reports should be the means of merchandising the company to the public. I suggest that there should be in the office of every accounting firm at least one merchandiser who can influence all towards a merchandising concept of the business of accounting.

Accountants have been engaged for some time in an attempt to standardize "accounting terms". Their decisions may have been based on what they consider is best. However, a true merchandiser would consider what terms will best convey to the reader an understanding of what he wishes the investor and the public in general to know.

In Toronto there is an old man, editor of a successful trade paper, who made a simple but profound statement, "If you want to be a successful merchandiser, find out what people want to know and then tell them". Of course you must tell them in words they can comprehend.

Let's apply this rule to the matter of "disclosures".

Consult the Shareholders

If an association of accountants were to make a survey of shareholders in all walks of life to find out what they want to know about the companies in which they invest, and then place the results of its fact-finding before those companies, it would revolutionize our annual reports in a short time. There would be no question as to what disclosures should be made, and the need for understandable simple language would be readily apparent. Why do so many companies print a separate report for their employees? Is it not an attempt to simplify statements about things which in themselves are not difficult to understand? Why is it necessary to draw pictures of rows of cottages, loaves of bread, bags of flour, piles of lumber, steel, etc., but for the necessity of translating obscure language into simple illustrations of things which themselves are not obscure?

In speaking of "disclosures" we get down as a rule to dealing with argumentative points that have to do largely with history — where a company has *been*. That is necessary, but surely where a company is *going* is of far greater importance.

A Company's Greatest Asset

As an investor, no matter how good a company's history may be, I am far more concerned with its future. That future is tied up inseparably with the greatest asset any company has, that is, the human asset. That asset is not shown on the balance sheet. I don't know why its value cannot be satisfactorily dealt with in the annual report. What good is derived from properly examining and disclosing the facts about an unsatisfactory inventory if the management condition that allowed such a situation to develop is not disclosed? Of what value is it to show that an inventory is all right, if the thinking and execution on the part of management is rapidly destroying the company's consumer franchise?

Surely, when mismanagement is evident there should be some indication of the situation in the auditors' report. How can the disclosure be made? There you have me, I don't know. But I raise the question — why is it not possible to appraise the human asset? Banks and financial institutions will lend money on balance sheets and bricks and mortar, but these will not pay them back. "People and not things make money", said Mark Hanna, and "people, not things" will pay them back.

Improvements in Financial Statements

Now, to be fair, there has been progress in improved financial statements. This progress has been influenced largely by the needs of those who have had the most extensive interests — the owner of the business, the shareholders, the creditors, and the investing public.

Financial statements of publicly-owned corporations as published today are intended primarily as reports to shareholders on the operation of the business and as guides to the investing public. To these groups the item of greatest interest is "net profit", or "what is left", after all costs of operation, for dividends and reinvestment in the business for its further development.

From my point of view, however, the purpose to be served by financial statements is to provide a full accounting of a business stewardship not only to its present and potential shareholders but also to its customers and its employees, as well as to the producers, manufacturers, processors and suppliers with whom it does business.

The development of mass production and new applications of science in all phases of business generally have enlarged the public stake in being fully informed about business. Furthermore, facts contained in modern company reports are of basic interest to the public, because, now more than ever before, these facts have a direct bearing upon the standard of living and the cost of living of the consuming public. As a result of this rapidly-increasing public interest in accounting and financial reporting, the consumer is beginning to learn that the results of business are closely related to prices, wages, dividends and security values.

Public Misunderstanding

Unfortunately, there still remains a very large proportion of the public which tends to regard big business as remote and impersonal, and run like a machine by some unknown group of policy-makers. These people misunderstand the development of business, the nature of business and how business works. All too frequently this misunderstanding expresses itself in a number of false impressions. One misconception is that corporate business organizations are set up to levy excessive profits upon the public and are therefore detrimental to the public interest. Another is that large corporations, especially those with widespread retail outlets, are owned by outside interests and bleed the communities they enter, whereas exactly the opposite is true. The annual report and its financial statements must be so designed and written as to remove all such false impressions and misconceptions, and to replace them with a respectful and healthy public attitude toward business. I take the liberty of quoting from the latest annual report of Dominion Stores Limited:

> In the economy of this great country of ours your company is playing an important role in the development of progressive communities throughout the four eastern provinces in which it operates 221 retail stores and two large distributing plants.
>
> The development of each Dominion Master Market is essentially a community project. The enviable position your company enjoys today is a story of progress through vision and confidence in great Canadian communities.
>
> In the building of the modern Dominion Master Market every consideration was given to the development we would bring to the communities served. The opening of these stores has contributed to each of the communities where they are located, both in increased revenue to the municipalities and in the enhancement in value of the adjoining property. In many instances the establishment of the New Dominion Master Market has constituted the hub of a new shopping centre.

We must remember that we have something to sell besides merchandise. We are financed by the public. Investors furnish the capital needed to run the business. What they think about the company determines the continuing market for our present stock and will determine the acceptance of any new financing we may need to undertake.

Attempts to gloss over public confusion about corporate affairs by the use in annual reports of pretty coloured pictures, futuristic designs and vague phraseology will not do the job.

Breakdown of Profits

Let us refer to the first misconception I mentioned previously — the levying of so-called unwarranted profits. By means of a simple accounting breakdown of the average sales dollar and properly-selected words the annual report can show how its revenue is divided between producers, suppliers, proprietors, municipalities, governments, employees and shareholders, and that the corporation is serving the common interests of all who share in its existence. In other words, the public interest in financial statements must be served through emphasis upon the mutuality of the interests of shareholders, employees, the customer of big and small business and of industry and agriculture. There is a need for increased public realization that shareholders in considerable measure (and the employees altogether) depend for their livelihood upon the manner in which the company serves the public. Since shareholders and employees are also our customers, no interest can conflict with another interest without also conflicting with itself.

The corporate annual report, together with its financial statements, as the official voice of business must become a new type of document to spread the true basis of business progress and to convey faithfully essential corporate messages to all its readers in a clear and comprehensive manner.

Evolution of Accounting

In the 18th century accounting problems were very simple and very different when compared with the complex problems of today. In earlier days business was largely private. There were very few, if any, industrial or commercial corporations. There were few stock exchanges or trust companies. Accountants in those days were concerned more particularly with straightening out books of account.

During subsequent years evolution in accountancy principles began to take form. Uniform standards gradually became more desirable and more necessary, as it was found that the same problem would often be handled in an entirely different manner by different accountants.

The evolution of accounting and financial reporting over this period of many years has developed a special vocabulary of technical terms, such as:

> ***depreciation, overhead, gross earnings, net earnings, gross profit, net profit, operating profit, surplus, earned surplus, capital surplus, capital, invested capital.***

These terms, together with innumerable other words descriptive of vital factors which enter into business as we know it today, perplex and confuse the great majority of people who find themselves unable to grasp their real meaning.

Conveying the Message

It is encouraging to observe that a great many companies, with the assistance of their auditors, are now joining the attack on the misleading and confusing words which I just mentioned, and a number of recent reports are outstanding examples of clarity and readability. In many instances, of course, technical terms are necessarily retained, but in such instances they are accompanied by understandable variations in terminology.

The members of the accounting profession are to be congratulated on their sincere efforts to bring into financial reporting the maximum of consistency and comparability, and to narrow the margin of difference in accounting procedures.

In our annual reports we must select and use terms which will convey our message to the reading public in a clear-cut manner. This is not an easy task. The acceptability of words, here as with food, is powerfully influenced by the manner of the mixing and serving.

It seems to me that accountants generally cling steadfastly to the tradition of conservatism. Many make it a cardinal virtue in the pursuit of their daily tasks, responsibilities, and considered opinions. I suppose it is only proper for this to be so. The very nature of their work and responsibilities requires accountants to examine and scrutinize new procedures thoroughly before accepting them in favour of so-called tried-and-true methods.

For Example: Prepaid Expenses

Unfortunately, many people seem to ignore new ideas simply because they are at variance with what they have been accustomed to for many years. For example, I refer now to the treatment of prepaid expenses as a current asset, recommended by your Committee on Accounting and Auditing Research two years ago. There are still many annual reports that apparently follow the old rule-of-thumb method that a current asset is something which must turn into cash within twelve months. This is not necessarily so. Why should a company which has paid rent in advance result in showing a lower working capital than that of a comparable company which pays its rent at the end of the month? The pre-payment of such expenses as rent, insurance, taxes, advertising, etc., certainly, in my opinion, does not impair the current position of a going concern in comparison with that of a competitor who defers such payments until a later date.

Balance sheets commonly classify inventories as current assets, even though this item is known to include, in many cases, operating supplies which are in a sense similar to prepaid expenses in that they are expected to be consumed in the normal course of operations. Salaries, wages, rents, taxes, light, power, telephone and other similar items are accrued and shown as current liabilities which reduce the working capital. If some of these expenses are prepaid instead of accrued, why should they be dropped from the current asset classification? It seems to me that if one accounting method is more logical and more useful than another, it should be generally adopted. The fact that the item in question is usually not of material importance is not a good enough reason for treating it illogically.

Source and Application of Funds

Our company accounting department, when reporting each quarter in long form to top management, includes a detailed report entitled "Source and Application of Funds", which I personally find to be most informative.

This statement, indicating the flow of cash in and out of the business, shows in a concise manner the changes in the financial position of a company, and is, I believe, of substantial use to most business men.

Such a statement, if presented properly and perhaps with more descriptive terminology, could be used very effectively in most annual reports and should prove to be of real value to the average reader when he raises the oft-repeated question, "What happened to all the money we made?".

Many published statements do little more than conform to the minimum requirements of the Dominion *Companies*

Act. This is perhaps understandable in certain cases when disclosure might give valuable information to competitors. If accounting and financial statements are to be useful to both business management and the public, however, the answer rests largely with the professional accountant to encourage better methods. After all, the certifying accountant in his report to the shareholders does state that in his opinion the statements are so drawn up as to exhibit a "true and correct" view of the affairs of the company.

An Opportunity to Make Friends

The financial annual report provides an important opportunity to make friends. It provides an opportunity to increase public understanding of your company and to build good-will among the thousands of people you do business with as customers, shareholders, and employees, and among the thousands of people who don't know your company at all. Business today, that is, *your* business and every other Canadian business, needs friends as it has never needed friends before. When you help people to understand your business a little better, you help them to understand all Canadian business, and you profit from this better understanding.

It would, in my opinion, be a great thing if some organization would inaugurate an annual contest, similar to that sponsored by *Financial World,* in Canada to encourage better disclosure and reporting to shareholders and the public generally.

Ethics and Economics

Mr. A. Dudley Ward, C.A., a member of the Ontario Institute, has assumed the directorship of a research project, undertaken by the Federal Council of the Churches of Christ in America, to determine the role of ethics in economic life. This study will deal with the crucial economic problems which are faced by leaders and members of the three basic economic groups — farm, labour and business. An example is the problem of equality among persons, which is grounded in an ethical concept but is also related to such fundamental economic issues as the distribution of income. Other major economic problems on which attention will be focussed are efficiency and productivity, industrial organization, private and public policy for the creation of economic stability, and the like. Throughout these investigations many of the central issues will be those confronted by the public accountant and the business manager. Mr. Ward expects that his work will take him into a consideration of some aspects of the Canadian economy also.

The Role of the Accountant In a Changing Social Climate

By R. A. McEachern
(Editor, The Financial Post)

Business can justify itself by telling the simple facts about itself, and herein accountants have a vital role

DURING the past fifty years we have moved from what, for convenience, may be called a free enterprise economy to a responsible enterprise economy. Half a century ago the over-riding point of view of business was "Me for myself and the devil take the hindmost". Now public opinion, backed with legislation, insists that business have a different point of view. It insists that business serve the social and, to an increasing degree, the spiritual needs of its employees and the community as a whole. Half a century ago, the businessman's key objective was big profit. But several things have happened to change the nature of the profit which corporations desire today.

The New Social Climate

First, of course, is the new social climate filled with the cries of the economic illiterates that profit is a bad thing. That particular piece of nonsense comes from all quarters, high and low. Unfortunately there is considerable evidence to suggest that corporate profits at today's level are not adequate over the long run to maintain the health and reproductive apparatus of our economy. Some Russian economists, for instance, see proof that the capitalist system is bound to collapse in the fact that our profits are too low.

Another factor affecting the size of profit objectives is the rather new North American approach to business. Henry Ford had the idea when he said, "I pay my workers high wages so they can buy my cars". North American business finds long-term health in selling refrigerators at modest profit to almost everybody rather than selling at big profit to a few. From there, of course, it is but a step to the realization that the size of the market is determined by the amount of wages paid.

Of course, there is also share-the-wealth taxation.

Pussy Cats and Tigers

Pussy cats and tigers both belong to the cat family, but the consequences of adopting them into your family circle differ markedly. There is the same difference in the economic and social consequences of pre-war pussy cat kind of taxation and postwar tiger type.

Taxation as applied in Britain, Canada, and the United States is no longer just a device for supplying the revenue needs of government. Equally or even more important is its use as an instrument for the achievement of assorted other social, economic and political objectives.

We share the wealth not only by

A paper read at the 47th annual meeting of the D.A.C.A., Toronto, Sept. 14

steeply graded income taxes, but by various subsidies, pension and insurance schemes, farm and fish price supports, government aid for home financing, and baby bonuses which are supposed to help the children but which have a more important economic objective of helping to put a floor under family income.

Now I am putting a good deal of emphasis on this revolution in the business climate because I fear there is a widespread disposition to ignore it, to try to pretend that it hasn't taken place, to pretend that one of these days we're going to get back what are supposed to have been the good old days. This is not to say that we favor all that has taken place, that we haven't serious apprehensions as to the longer term consequences, that we are not seriously concerned about the implications for individual freedom. Nevertheless, the fact is that this revolution has taken place, and to you I leave the answer to the question whether any political party could win an election on a platform of "Back to the good old days".

The point is this: since business is no longer permitted large profit, the primary objective of business has become its security and permanence, the comfort and prestige of its executives, the comfort and security of employees, the welfare of the community as a whole. Today business lives in a glass house, whether it likes it or not, and the number of businesses which have anything to hide, anything to be ashamed of, is very, very small. This is a very powerful reason why today's business should be eager to get its story — the whole story — into the hands of the public.

A Job of Public Education

To prevent ruin of our system which I profoundly believe best serves the interests of the whole community, and to prevent national bankruptcy as a result of social services outrunning our capacity to provide them, business has a major job of public education to do — and the best way to do that is not hiring professional propagandizers for free enterprise, not subsidizing political parties, but telling the simple facts about itself. Just think of the results if every employer succeeded in educating each of his employees on the merits of our business system.

Here in Canada, every few days, we have pitiful demonstrations by prominent people, who should know better, that they do not know the elementary facts of business life. Our whole society must learn — and this is extremely urgent — that the only way for any group to get a bigger slice of the cake is to help in producing a bigger cake.

The Place of Accounting

It seems to me that the fundamental question is this: have accounting practices kept pace with the other changes which have taken place and have they yet been adjusted to the new climate in which business operates?

I think it is true to say that many of the formulae now used in making up the published statements of corporations had their origin in a desire to tell as little and conceal as much as possible. Fortunately, we are not as bad as it used to be in Delaware which used to advertise, "Incorporate here; no annual statement required; nothing need be revealed".

For today's situation, the financial statements of a company should serve two functions:

1. Present the facts for the shareholders.
2. As effectively as possible do the educational job I have mentioned on the firm's employees and on the masses generally.

Let's look at how the present formula serves the interest of the shareholder.

Certainly none of us would for a moment think of buying a business, or

even an important stock interest in a business, solely on the basis of what we can find out from its balance sheet and income account.

There is, of course, wide variation in the reporting practices of various companies and auditing firms, but how well does the *average* financial reporting serve the interests of the ordinary shareholder?

An annual statement is just a snapshot of a company at some particular moment of time. What the investor wants to know is direction — where the company is going. He needs to look at a series of snapshots. So why should annual reports not give key figures for a series of years?

The asset figure doesn't mean much until you find out what assets are current. The investment figure means little unless you know what is marketable, what non-marketable and how valued. The inventory and the method of valuation and whether before or after inventory reserve is vital information in many cases. Fixed assets mean little unless you are told the method of valuation. On current liabilities the investor has a very legitimate interest in knowing if some of the liabilities are deferred and when they come due. He is entitled to a clear distinction between operating reserves and other reserves which are free and unallocated. And what about the income account? Again the shareholder is left in the dark on many important things.

Very often an annual statement omits to tell one of the most important facts of all — operating expenses. Starting off with a net earnings figure before depreciation and bond interest gives quite an inadequate picture. Making no distinction between earned income and capital gains is just misleading. Usually there is no separate item for wages.

If you were buying a business you would most certainly want sales figures and figures on the cost of sales, and you know how few companies tell these to their shareholders.

No Excuse For Withholding Information

Of course, we all know the reason usually given for not doing so: they say it would be valuable information for the competition. That's just nonsense. By revealing sales figures you do not lose any more, or gain any more, than your competitor. Any sales manager on his toes, even under today's supposedly supersecrecy, knows very closely his opponent's sales, anyway. In half a dozen cases, I have raised this question of sales figures with Canadian firms and almost always the alert executive replies, "Yes, we'll show our figures if our competitor will show his". Revealing sales figures is something which the shareholder is morally entitled to demand, but it is something which, to become general, will have to be required by legislation.

Another place where legislation is definitely required is in the case of companies having subsidiaries. There are some cases which are just shocking. Everyone concerned with giving the shareholder a square deal and with the good reputation of the business system must join in the demand that we get either consolidated balance sheets or full disclosure on subsidiary operations. Nor is it too much to demand that shareholders be told about their company's stock interest in other companies. Where a company owns say 33% or more of the stock of another, shareholders are entitled to know the name of the company and the extent of the interest. Where information of this nature is hidden, there are many opportunities for suspicion.

More Frequent Reports

Brief interim reports, say quarterly, are becoming increasingly common, but they should be universal. Why should this important information be the exclu-

sive property of insiders? Sometimes the excuse is given that quarterly reports would be misleading and that seasonal and other variations would make the picture too bright or too dark. That, of course, is nonsense, because anybody with enough sense to read a statement at all will have enough sense to compare quarterly figures with other figures for similar quarters. Since earnings figures are so closely related to stock price movement, insiders quite obviously have an unfair advantage over ordinary shareholders when information about the trend of earnings is bottled up for a whole year.

I do not profess to tell an accountant how to conduct his business, but there would be great benefit in much greater uniformity as to practice and as to definition of terms. Just as an example, take the word "profit" which now may mean several very different things in accounting, but in the public mind profit means only one thing. Let's have the word profit appear only once in annual statements, and that at the very end, giving the final figure after every charge and every tax has been taken care of. Do that, and we will avoid much confusion. The suspicious will then have minimum opportunity for misunderstanding and distortion.

Let me emphasize again that the accounting profession has a big role to play in the educational job, in demonstrating and making clear to the millions that business is honest, that without profit there can be no jobs.

How Accountants Can Help

Now, briefly, let me say something about how accountants can help business do the educational job — the job of making the business facts simple for all. The place for a corporation to start this job obviously is with its own employees and their families. There may be some good reason, though I don't know what it is, for continuing the traditional formal style of reporting to boards of directors. But if there is, why not, in addition, give your clients a simplified statement which every employee and his wife can follow and understand?

My avowed reason for interest in the subject of annual reports is that I am a newspaper editor and the role of a journalist is to represent the public at all matters of public interest.

Courts of law are open to the public on the theory that proceedings must be open and above board, that both sides get proper hearing. Few people make a hobby of watching the courts in action. The press does. Similarly, it is the function of a paper like the one I direct to represent the public in business matters affecting a body of citizens.

Few shareholders attend meetings of the companies in which they are part owners. Because of the very inadequate information companies are required to reveal, it probably doesn't make much difference. As you well know, some annual meetings are arranged and conducted in a way which seems calculated to prevent or minimize questioning. As a further precaution, some companies hand annual reports to shareholders just as the meeting gets started. This gives shareholders no time to examine the report, and to ask intelligent questions about it.

The Press

Here is the way *The Financial Post* operates:

Our representatives attend a great many shareholders' meetings. Sometimes we ask questions which shareholders should have asked had they done previous close study of company operations. I may add that some companies get very indignant indeed when we ask questions. Very occasionally they try to keep the press out of shareholder meetings alto-

gether. That is very silly because when anybody doesn't want the press in, it is a good indication that we should be in and that something very interesting is going on.

It's very simple to become a shareholder in a public company, so that practice of excluding the press just doesn't work the second time.

Not long ago, a public company here in Toronto told us no annual statement would be available to anybody. We pointed out the legal error in that. They then decided to make a report available to shareholders only. That tipped us off that there was something specially interesting in the report; we got one promptly and, to be sure, there was something there that shareholders should indeed ask questions about, and we brought it to their attention in print.

There are other ways in which we do the job which the well-informed and well-equipped shareholder should do for himself. We go over annual statements with a fine-tooth comb. Then we set up the account in a standard form we have worked out where every item means exactly the same thing in every case. We watch for any new items in the report, watch for any unexplained deviations from previous years. We may then put questions direct to the company executive to get information which is important to all shareholders.

Private Playthings of Officers and Directors

However, no matter how well we do at analyzing statements, digging out the questions that should be asked, and at getting answers to them, the truth remains that ordinary shareholders do not get nearly enough information. Under present law and practice, some public companies are still the private playthings of officers and boards of directors. The stock company, designed to be the perfect democracy, remains in fact in most cases a feudal barony with one set of privileges for the knights, another for the serfs. This situation is not in keeping with the realties nor the conscience of present day society.

When business is under attack, and when the real facts about business are its best defence, it is just elementary common sense that company practice in telling about itself should catch up on its half century lag. These days a great deal of money and effort is spent on advertising and public relations. The best definition I know of public relations is "Doing the right thing and getting credit for it".

For any company, then, the best way to show that it has done the right thing, and to get credit for so doing, is to show the family bookkeeping accounts for all to see.

A Recent Book

Montgomery's Auditing (Seventh Edition), by Robert H. Montgomery, Norman J. Lenhart and Alvin R. Jennings; The Ronald Press Company, New York, pp. 571, index and appendices, $6.00 (U.S.)

The birth of each new edition of "Montgomery's Auditing" should be hailed with joy by all accountants, whether practising or not. The latest member of the family arrives nine years after its immediate junior, the sixth edition and, while there is a strong family resemblance between the two, there is more than enough difference to establish their separate personalities.

The seventh edition has been completely rewritten and in this task Colonel Montgomery has had the assistance of two of his partners. A complete rewriting of the book was necessary, not because the sixth edition was inadequate at the time of its publication, but because of the changes in accounting literature and thinking during the intervening years. Since the previous edition was published almost all of the bulletins of the Accounting and Auditing Committees of the American Institute of Accountants have been issued as well as most of the Accounting Series Releases of the Securities and Exchange Commission. Many accountants will find the codification of these bulletins and releases, under the appropriate topical headings, the most useful function of this book.

Some accountants will sit down and read the book from cover to cover and it must be admitted that this would be a good refresher course for all to take. To most, however, 648 pages of reading will seem too heavy an undertaking to add to a busy practice and for them the book will be kept as a reference and used to clarify thinking or establish an authority when some particular problem must be dealt with. But any accountant, practising or otherwise, could spend a few useful and entertaining evenings skimming the contents and reading those sections of greatest interest. Colonel Montgomery's "Preface" should certainly be read by all. After that, each reader's choice will depend upon his interests and his problems.

In each case when dealing with the assets, liabilities, revenues and costs, the subject matter is divided into four parts. In the first, accounting principles are stated. (I suppose "Montgomery's Auditing" is more frequently used as a reference on accounting principles than for any other purpose. Certainly the title of the book indicates a much more limited field than is actually covered.) In the second part of each of these chapters, the principles of internal control are set out and these comments are supplemented by 74 pages of internal control questionnaires for various kinds of businesses which are to be found at the end of the book. The third part deals with auditing procedures and the fourth with statement presentation. This is a logical arrangement and one which should be useful to both the student and the practitioner.

"Montgomery's Auditing" has something for everyone and a copy of the seventh edition belongs in every accountant's library.

J. R. M. Wilson, F.C.A.

•

Establishment of Uniform Requirements For the Practice of Public Accounting

By K. LeM. Carter, F.C.A.

An outline of the organization of the public accounting profession in English-speaking countries

INCREASING inter-American trade produces further need for complete understanding of financial reporting in the countries trading. An auditor's report on financial information is its hallmark of integrity. It is, therefore, the responsibility of our profession in all countries to strive for high integrity of public accountants as well as uniform standards of skill and methods of presentation.

Four uniform requirements are suggested as being basic to a common practice of public accountancy in America in order of importance as follows:

1. A clear understanding of the meaning of public accountancy,
2. Similar principles of education and training,
3. Common standards of important professional ethics,
4. Accounting technique and terminology which is understandable throughout.

Public Accountancy

For the purpose of a regulating bill in the Province of Ontario, public accountancy has recently been defined as "the investigation or audit of accounting records or the preparation of or reporting on balance sheets, profit and loss accounts or other financial statements . . . but shall not include bookkeeping . . ." In the same proposed bill a public accountant is one "who . . . carries on the practice of public accountancy and in connection with that practice offers his services for reward to members of the public . . ."

The foregoing is quoted as a general definition which might equally be applied to any of the British Commonwealth nations or the United States.

The exclusions from this definition are primarily those accountants who are employed by commerce, government or teaching institutions and persons whose sole practice consists of bookkeeping. A difficult distinction sometimes arises between public accountancy and auditors of government bodies when the latter have some measure of independence because they report to the legislative branch of a government on their audit of the executive accounts. The difference between public bookkeeping and accountancy is simpler, being basically a distinction in skill. It may appear rather graceless to cast aside the keepers of books when our forefathers produced a profession out of that honest toil. However, in doing so, they passed to us more

A paper read at the Pan-American Conference of Accountants, Puerto Rico, May 1949

advanced and troublesome problems which have resulted in the development of a scheme of education and training to qualify for the verification and interpretation of financial information.

While a public accountant is one who offers his services to the public for investigating or auditing accounts, and preparing and reporting on financial statements, he generally carries out various corollary services such as tax advice, bookkeeping, cost accounting, receiver and liquidator in bankruptcy. However, these services, while generally equally profitable, do not in themselves constitute public accountancy.

The Institutes of Chartered Accountants in the British Empire and the American Institute of Accountants consist of persons who have qualified as public accountants but do not necessarily continue in practice. In fact, of the total Canadian membership of about 3,000, approximately one-half do not engage in public accountancy. It may, therefore, be concluded that the course of training and education laid down for public accountants has proven valuable in many other fields.

Education and Training

The method of qualifying accountants in the Dominions and the United States springs from the English industrial plan of indentureship. The English Institute permits one articled clerk for each member in practice. This highly selective procedure has maintained the best standards but has tended to restrict candidates to those whose parents could afford to purchase an indentureship. Other British countries and the United States have retained the apprenticeship or trainee principle which requires initial academic standards, the passing of some examinations and a period of service. Broadly, the period of service varies from one to five years as between various localities and may further vary within localities by reason of initial academic standing. From this, it appears well established that, in addition to a prescribed standard of learning, the qualified public accountant must have some period of experience.

The apprenticeship method, while generally recognized as most suitable to our profession, should not be accepted too readily. The wastage from examination failure is high. Of the candidates writing the final English and Canadian papers, it is normal for 60% to fail, and the rate is probably higher in the United States. This may be due to faulty choosing of the trainees or to the difficulty of combining tuition with service, or to both. While study is being given in the United States and Canada to the correction of this loss, it is not fully understood. Committees are at work in the United States and Canada developing personnel selection tests and interview methods which it is hoped may eventually be employed to choose those students only who are likely to succeed in the profession of public accountancy.

The type and extent of desirable educational standards does not seem to be clearly defined. The American Institute requires certain courses in financial subjects without particular regard to general subjects of higher learning. Some of the Canadian provinces give service credits for liberal arts courses, and students with university degrees generally receive prior consideration for available positions.

It is frequently argued that, if accountancy is to progress as a profession, its members must be drawn from the educated class and that the only means of assuring a suitable standard is to confine our future members to those holding degrees of higher learning. Whatever may be the force of such a statement, it is also essential that public accountants acquire a sound theoretical knowledge of accounts.

Ethical Standards

It is almost unnecessary to suggest that a profession requires some regulation of its members by its members for the good of all. A code must serve the interests of the public and of the profession.

The codes of professional conduct of the English-speaking countries are reasonably similar. Some of the more important public obligations are:

(1) Independence

This is probably the most important rule, for the accountant's report must be free from any suggestion as to influence. Canadian company laws prohibit an auditor from serving as a director of a public company, although such prohibition would seem unnecessary since, by serving both offices, an auditor would be unable to report objectively and the public would be unwilling to accept such a person's report.

It is interesting to note the comments of Mr. John Carey, secretary of the American Institute of Accountants, in his "Professional Ethics of Public Accounting":

> Independence is an abstract concept, and it is difficult to define either generally or in its peculiar application to the certified public accountant. Essentially it is a state of mind. It is partly synonymous with honesty, integrity, courage, character. It means, in simplest terms, that the certified public accountant will tell the truth as he sees it, and will permit no influence, financial or sentimental, to turn him from that course.
>
> The rules not only provide for punishment of members who are not independent; they also prohibit conduct which might arouse a suspicion of lack of independence. Objective standards of independence have thus been introduced into the code. It is not enough for the member to do what he thinks is right. He must also avoid behavior which could lead to an inference that he might be subject to improper influences. The accounting profession must be like Caesar's wife. To be suspected is almost as bad as to be convicted.

(2) Misleading Statements

The Canadian provincial codes prohibit a member from associating himself with any financial statement or report which might tend to confuse or disguise the actual situation. The American code further provides that an act discreditable to the profession includes gross negligence in an examination or report, failure to acquire sufficient information to warrant an expression of opinion or to direct attention to any departure from generally accepted accounting principles or auditing procedures. This last charge is made possible in the United States by the codification of some of the more important accounting principles and auditing procedures.

(3) Commissions, etc.

Members are prohibited from paying commissions for work received, except to other accountants, or from sharing their profits with persons who are not members; nor are they permitted to form partnerships with non-member accountants.

In addition to the rules to serve the interests of the public, there are several rules which are mainly concerned with the profession. These are designed to secure dignified relations as between fellow-members. They restrict advertising and the solicitation of business so that the competitive spirit may be tempered by kindness. They also require that, before offering employment to one of the staff of another member, enquiry shall be made of the member as to reasons for the employee's dissatisfaction.

In the Canadian Institutes, these rules are generally policed by the members themselves, and infractions are brought to the attention of disciplinary committees. Most complaints are disposed of by correspondence or an interview, but each year brings a few trials for serious

breaches. Fortunately, the rules are well understood and trials of recent years have all been concerned with faulty workmanship.

Terminology and Standards of Disclosure in Financial Statements

Because, within the English-speaking countries, accountancy has sprung from the British Isles within the last seventy-five years, there is reasonably similar terminology throughout. The same degree of uniformity does not pertain to the preparation of financial statements because the English have been reluctant to abandon the 'account' form, while in the United States and Canada it has long been discarded as too technical for the intellectual level of the average investor. The widest departure is, of course, in the entering of the items on a balance sheet. The English, or more probably the Scots, prefer to list the liabilities in the left column and the assets in the right, while the profligate North Americans first array their property and then list their debts. This inconsistency must cause much inconvenience in many parts but it is not a fundamental departure.

The English *Companies' Act* of 1948 has brought us closer together in the important matter of disclosure, particularly with regard to the consolidation of accounts of affiliated companies.

The accounting and auditing bulletins of the English, American and Canadian Institutes are examined carefully by each of the other two Institutes which tends to maintain a degree of uniformity between all three. Each employs some research staff who advise the research committees on current problems and prepare material for bulletins.

The Canadian committee is now in the course of preparing a release on terminology. This will lay down definitions for some hundreds of accounting terms and should prove a valuable contribution to uniformity.

Conclusion

Public accountancy has been developed in Great Britain, the United States and Canada without much assistance from legislation. Audits were required of English companies by statutory amendment in 1900. A similar Canadian requirement was imposed in 1919. The general company laws of these countries have never specified the qualifications of auditors other than to exclude certain persons otherwise connected with the companies. There are a few statutes like the Canadian *Bank Act* which provides that an auditor of a bank shall be a chartered accountant with at least ten years' practice in Canada, but these are exceptional.

The reluctance of legislatures to grant exclusive franchises for practice to the responsible accountancy bodies has caused many persons in all three countries to hold themselves out to the public as public accountants even though they lack qualifications and owe no responsibility to organized accountancy societies. This confused situation is receiving attention. A bill is soon to be presented to the government of Great Britain to license public accountants in that country. Of the forty-eight United States of America, at least eighteen have now passed laws restricting practice in various ways. Two years ago the Canadian Province of Quebec granted to the Institute of Chartered Accountants of that Province exclusive control of the profession within its boundaries. Other Provinces are considering accountancy regulations.

While control of the profession within a jurisdiction by any one body is not essential to its successful growth, it is probable that such control would facilitate the development of high ethical and technical standards. This follows only if the franchise rights are not acquired at the heavy cost of government supervision. The professional body must be free to accept, reject and expel members strict-

ly according to professional standards.

This paper does not specify control as a uniform basic requirement, but mentions it only as a step desirable to attain a sound international foundation.

The establishment of international accounting committees to review at least the four basic requirements set forth above should prove fruitful. The source of material is abundant and a discussion of experiences under varying conditions would be instructive to all concerned.

Obituaries

Gordon Albert Holmes

The Institute of Chartered Accountants of Ontario announces with deep regret the death, after a long illness, of Gordon Albert Holmes in his thirty-fourth year. Mr. Holmes was born in Ottawa and attended McGill University, where he belonged to Theta Delta Chi fraternity. He served articles with A. A. Crawley & Co. of Ottawa, and after three and one-half years' overseas service in the Royal Canadian Ordnance Corps he joined the staff of the Auditor General of Canada in 1946, where he remained until his death. He became a member of the Ontario Institute in 1948. To his brother, Douglas Scott Holmes, the members of the Ontario Institute extend their sincere sympathy.

William Carswell

The President and Council of The Institute of Chartered Accountants of Ontario regret to announce the death of William Carswell in Montreal earlier in the year. Born in Newcastle-on-Tyne, Mr. Carswell was educated at Rothesay Academy and Edinburgh University. On coming to Canada he served with Price Waterhouse & Co., Chartered Accountants, and became a member of the Ontario Institute in 1919. Leaving the public accounting profession in 1920, he joined the Northern Electric Company Ltd., and at the time of his death was vice-president in charge of accounts and finance. The President and Council, on behalf of the members of the Institute, express their sympathy to his wife and family.

Professional Notes

QUEBEC

Quebec Students' Society

The opening dinner of the Chartered Accountants Students' Society of Quebec was held recently in the Queen's Hotel, Montreal. On this occasion the guest speaker, Mr. Louis-J. Trottier, C.A., assistant general manager of the Provincial Bank of Canada, addressed the well-attended gathering of French and English students on "Your Bank and Its Services". The meeting was conducted entirely in French, and Mr. Trottier was introduced by Mr. C. N. Knowles, C.A., honorary president of the Students' Society, and thanked by Mr. Marcel Caron, C.A., vice-president.

The Chartered Accountants Students' Society of Quebec has added two new features to its programme for the 1949-50 season. One is a machine accounting course, which consists of several visits to plant or sales offices of the various manufacturers of machine accounting equipment, where details of the use and operational features of the machines are explained to the chartered accountant and student members. The second is a public speaking group which is conducted in both French and English, and is supervised by capable instructors.

Quebec Students' Society

Quebec City Branch

The Chartered Accountants Students' Society of Quebec announces the organization of a branch in Quebec City with the following executive: *president,* Maurice De Coster, C.A.; *vice-president,* Marius Laliberté, C.A.; *secretary-treasurer,* Roger Stanton, C.A.; *directors,* Dollard Huot, C.A., Armand Picard, Roger Letourneau and Pierre Vaillancourt. All chartered accountants in Quebec City and vicinity, in addition to students, are invited to support this newly organized unit of the Students' Society. Information may be obtained from Mr. Roger Stanton, C.A., 24 Raymond Casgrain St., Quebec, or from the Society's office.

ALBERTA

Glendinning, Jarrett, Gray & Roberts, Chartered Accountants, announce the appointment of Mr. J. I. Bell, C.A., as resident manager of their Calgary office.

* * *

Mr. F. G. Winspear, C.A., partner in the firm of Winspear, Hamilton, Anderson & Co., Chartered Accountants, Edmonton, has been elected first vice-president of the Canadian Chamber of Commerce.

BRITISH COLUMBIA

Mr. A. M. Lipman, C.A., 528 Rogers Bldg., Vancouver, announces that his practice is now being conducted by Collins & Collins, Chartered Accountants, Vancouver, B.C.

ONTARIO

Mr. Ross E. Neal, C.A., announces the opening of an office for the practice of his profession at 297 Front St., Belleville, Ont.

* * *

Mr. Donald D. Gurarie, C.A., announces the removal of his office to 430 King St. W., Toronto, Ont.

NEW BRUNSWICK

McDonald, Currie & Co., Chartered Accountants, announce the opening of an office in the Subway Block, Moncton, with Mr. John F. O'Neil, C.A., as resident partner.

* * *

Maritime Institutes' Annual Meeting

The three Maritime Institutes of Chartered Accountants held a two-day session at the Admiral Beatty Hotel, Saint John, on Friday and Saturday, October 21 and 22. The highlight of the meeting was the annual dinner on Friday evening at which the guest speaker, Dr. A. W. Trueman, president of the University of New Brunswick, discussed the value of the humanities in higher education in Canada. Mr. George Hudson, C.A., vice-president of the New Brunswick Institute presided. Other speakers at the business sessions included Mr. H. R. Doane, C.A., president of the D.A.C.A., Mr. C. L. King, B. Com., C.A., secretary of the Association, Mr. L. N. Buzzell, C.A., and Mr. G. K. Laing.

SASKATCHEWAN

Regina Chartered Accountants' Club

The Regina Chartered Accountants' Club held their first meeting of the 1949-50 season at the Kitchener Hotel in Regina, Wednesday, October 12, 1949. Mr. T. H. Moffet, F.C.A., past president of the Dominion Association, reviewed the highlights of the Dominion Convention held in Toronto September 14, 15, and 16, stressing in particular the discussions in connection with the courses of study for students, the work being conducted by the Research Committee of the Dominion Council, and the value of panel discussions on professional subjects. Mr. C. H. Smith expressed the appreciation of the meeting to Mr. Moffet. Mr. W. A. Fowlie, retiring president, was in the chair. Officials elected for the new year were as follows: *president* — H. A. Hunt; *vice-president* — D. A. Shaw; *Executive members* — W. H. Bailey and S. C. Dale; *secretary-treasurer* — J. H. Gordon.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

ONE day to satisfy an unusual curiosity as to the relative size of various Canadian manufacturing industries, we turned to *The Canada Year Book* (1948-9). The most recent figures there are for 1946, and we found the following to be the largest Canadian manufacturing industries:

1. Pulp and paper
2. Slaughtering and meatpacking
3. Non-ferrous metal smelting and refining
4. Sawmills
5. Flour and feed mills
6. Butter and cheese
7. Electrical apparatus and supplies
8. Petroleum products
9. Automobiles
10. Clothing, women's factory.

We were then unfortunate enough to mention our findings to one who proved to know a good deal more about these things than we did.

"The second largest manufacturing industry in Canada", we announced casually, "is slaughtering and meatpacking."

Our friend was not impressed.

"Largest in terms of *what?*" he asked.

Considerably irritated at what seemed an unnecessary question, we fumbled through some papers and learned we had been talking in terms of an obscure thing called "gross value of production".

Then our friend gave us a little lecture on the subject.

"The slaughtering and meatpacking industry", he observed, "may be the second largest in terms of gross value of production, but I doubt if it's that big in terms of *value added*. You know they start with a raw material that has a high value relative to the value of their final product. I doubt if the industry contributes as much to the value of the final product as quite a number of others."

Disillusioned, we returned once more to our *Canada Year Book* (1948-9). As had been suggested, we found that there were also figures for *net* value of production, which we take to be the equivalent of "value added". (Net value of production is defined as gross value of production less cost of materials, fuel, and electricity.) We listed the first ten Canadian manufacturing industries on this basis:

1. Pulp and paper
2. Electrical apparatus and supplies
3. Sawmills
4. Rubber goods
5. Machinery
6. Breweries
7. Clothing, women's factory
8. Printing and publishing
9. Railway rolling stock
10. Bread and other bakery products.

Slaughtering and meatpacking was not even among the first ten! (In fact it was fourteenth.) Printing and publishing, which had been well down the list in terms of gross value of production, showed a very high percentage of value

added to final value of production and now placed eighth. Several industries that did not appear in the first list asserted themselves in our second one. We were quite intrigued.

Looking back on it now, we have to admit that once we had sunk our teeth in this business there was hardly any stopping us. We prepared still another list of the ten largest Canadian manufacturing industries, this time using number of employees as our criterion:

1. Sawmills
2. Pulp and paper
3. Electrical apparatus and supplies
4. Bread and other bakery products
5. Clothing, women's factory
6. Railway rolling stock
7. Clothing, men's factory
8. Machinery
9. Primary iron and steel
10. Slaughtering and meatpacking.

Now what is the moral of what we did? Not much, we suspect. But we do recall some people once having made a list of the ten largest Canadian industrial concerns using as their basis of comparison the total dollars on the asset side of the various published balance sheets. We need hardly point out that accounting practice varies between companies enough to make such a comparison very questionable indeed. The adequacy of asset valuation reserves (bad debts and depreciation) certainly differs between companies. Moreover, some companies may not deduct the reserve for depreciation from the fixed assets but show it instead on the right hand side of the balance sheet. Then there is also the whole question of inventory valuation. Finally, as if this were not enough, one must still decide whether *earning power* rather than dollar value of assets is not after all the best criterion of company size.

CORRESPONDENCE

Edmonton, Alta.

Sir: The writer was reading with interest your reply in connection with the handling of the deficit account on the balance sheet in the September issue of *The Canadian Chartered Accountant.* I wish to take exception to one paragraph where you say there cannot be a balance sheet of a going concern when the deficit exceeds the capital. It is quite conceivable; as a matter of fact I have run across this very situation in that the paid up capital of a company was low—as many of them are in the present day—and the company incurred losses exceeding this during the early months of operation. To cite an example: shareholders have $20,000 cash in order to begin a new business. Of this $20,000 possibly $20.00 or even $15.00 will be shown as share capital and the balance as loan by shareholders and shown as such on the balance sheet as a deferred liability. Therefore, in the operation of the new company it is quite conceivable that for the first few months after organization it will operate at a loss and a deficit will occur, but the shareholders are still financing the company and not the creditors. The reason for this is fairly obvious in that the shareholders can withdraw their original investment, tax free, at a later date when the company can stand it; whereas if the whole amount is capitalized their investment can never be withdrawn without the surplus being distributed.

B. W. Collins

Quebec City, P.Q.

Sir: I wish to take exception to your statement (September, p. 138) that: "There cannot be any balance sheet of a going concern when the deficit exceeds the capital stock".

The theory may apply to large corporations that cannot operate when the capital is seriously impaired, but small companies sometimes carry on operations even after their capital has been wiped out. I have in mind two concerns whose issued capital is inadequate. Both are financed through bank loans, secured in one case by the personal

guarantee of the directors and in the other, by the personal guarantee of the principal shareholder's brother.

The two companies carry on business despite the fact that their deficits exceed their capital stocks, and balance sheets have had to be issued. The question then came up as to the proper treatment of deficit and the following solution was evolved.

The net deficit was shown on the asset side of the balance sheet, but as a separate section distinct from the assets, thus:

EXCESS OF LIABILITIES OVER ASSETS
(*assumed figures*)

Deficit:		
As shown on attached statement		$17,000
Less: Capital-Stock		
Authorized:		
500 shares at $100 each $50,000		
Issued and paid up:		
120 shares	$12,000	$5,000

Although it appears on the asset side of the balance sheet, the deficit is clearly described as such and the reader is not lead to believe that it is an asset. The only alternative would have been to deduct the deficit from the liabilities, which did not seem logical.

This situation may have been encountered elsewhere and I would be glad to hear of any other solution.

MAURICE DECOSTER, C.A.

SOLUTION TO LAST MONTH'S PUZZLE

Anne is $15\frac{3}{4}$ years old.

Let Anne's present age = x years.

Some time ago Anne was $\frac{21}{2}$ ($=10\frac{1}{2}$) and at the same time Mary was x years old.

Anne is now x years old and Mary is now 21 years old.

Since they each grow older at the same rate, the increase in Anne's age must be the same as the increase in Mary's age.

$$x - 10\tfrac{1}{2} = 21 - x$$
$$2x = 21 + 10\tfrac{1}{2}$$
$$x = 15\tfrac{3}{4}$$

Proof: Since Mary is now 21, she was Anne's age $5\frac{1}{4}$ years ago.

Anne was $10\frac{1}{2}$ years old $5\frac{1}{4}$ years ago.

Mary is now twice as old (21) as Anne was $5\frac{1}{4}$ years ago.

Mary is twice as old as Anne was when Mary was as old as Anne is.

AN ACCOUNTING QUESTION FROM AN AMERICAN EXAMINATION*

Editor's note: Following the suggestion of a member of The Chartered Accountants Student's Society of Quebec, we reprint below an accounting question as it appeared in the Students' Department in *The Journal of Accountancy*, August 1949. It is a part of the May 1949 examination in theory of accounts prescribed by the American Institute of Accountants. The solution represents the opinion of the editor of the Students' Department, Mr. Thomas W. Leland, C.P.A. with whose kind permission it is reprinted here.

(*Uniform certified public accountant examination prepared by the board of examiners of the American Institute of Accountants and adopted by the examining boards of forty-seven states, the District of Columbia and four territories)

No. 1 (12½ points)

Present accounting theory is based on the assumption that the "value of money" is relatively stable. If there is a significant change in the price level, or in the purchasing power of the dollar, problems arise in interpreting income data as determined under conventional accounting procedures.

State and explain briefly the nature of such problems as related to inventories and fixed assets. You need not attempt to offer solutions to these problems.

Answer

During the course of the operation of a business acquisition costs are consumed in the production of revenue. If there is a substantial change in price level occurring between the time assets are acquired and the time the cost value of assets is considered to have expired or to have been used, the revenue and cost expired are stated in terms of dollars having different purchasing power. Therefore, there is an amount of income reported which from an economic viewpoint is a mixture of profit or loss from price level changes and of profit or loss from operations.

Because inventories and fixed assets are the assets usually involved where there is a long time lapse between purchase date and the time they are charged against revenue in the income statement as consumed costs, the income measurement problem arises chiefly in connection with those two groups of assets. The problem is frequently approached from the asset side. This presentation of the problem usually proceeds by pointing out that the amounts currently being charged against income are either in excess of (if price level has declined) or less than (if price level has increased) the present replacement cost of the goods or property consumed in producing revenue. Therefore, net income is either overstated or understated in comparison with the gain or loss from operations as determined by matching current replacement cost with revenue. While accountants recognize some validity in this argument, except for certain inventory methods which afford some correction, the usual basis of reporting net income has continued to be incurred cost rather than reproduction or replacement cost.

A basic difficulty in the way of satisfactorily accounting for variations in incurred cost and replacement cost of fixed assets has been that replacement cost will not be definitely known until some future date when replacement actually occurs. Such future replacement cost may not be subject to any reasonable estimate. The lack of objective evidence to support a depreciation charge that takes into consideration a changed price level has also been a major factor in preventing the recognition of the effect of price level changes in the income account.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect of course the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, November 1948

Accounting II, Question 6 (20 marks)

On 31 Dec. 1947, Acme Co. Ltd. purchased all the capital stock of Barto Co. Ltd. and 75% of the capital stock of Crown Co. Ltd. At the same date, Barto Co. Ltd. issued 5% bonds, of which Acme Co. Ltd. purchased $140,000 at par.

The following are the trial balances of the 3 companies as at 30th June 1948:

	Acme Co. Ltd.	Barto Co. Ltd.	Crown Co. Ltd.
DEBITS			
Cash	$ 70,000	$205,000	$ 50,000
Accounts & notes receivable	190,000	285,000	180,000
Inventories	156,000	95,000	200,000
Investments —			
Barto Co. Ltd. at cost	450,000		
Crown Co. Ltd. at cost	285,000		
Bonds—Barto Co. Ltd.	140,000		
Loan—Crown Co. Ltd.		80,000	
Fixed assets	350,000	180,000	240,000
Organization expenses	20,000	8,000	10,000
	$1,661,000	$853,000	$680,000
CREDITS:			
Accounts & notes payable	$ 375,000	$180,000	$196,000
Loan payable—Barto Co. Ltd.			80,000
5% bonds payable	400,000	200,000	
Capital stock	800,000	440,000	360,000
Earned surplus—			
as at 31st December 1947	40,000	8,000	24,000
For 6 months ending 30th June 1948	46,000	25,000	20,000
	$1,661,000	$853,000	$680,000
Contingent liabilities	$ 150,000	....	$ 40,000

During the 6 months ended 30th June 1948, Acme Co. Ltd. sold goods costing $40,000 to Barto Co. Ltd. for $70,000. The goods were all sold by Barto Co. Ltd. during the six months.

Required:

(a) Consolidated working sheet.

(b) Schedules showing details of eliminations and other adjustments.

(c) Consolidated balance sheet.

A SOLUTION

(a) ACME COMPANY LIMITED AND SUBSIDIARIES

CONSOLIDATED WORKING SHEET

as at 30 June 1948

	Acme Co. Ltd.	Barto Co. Ltd.	Crown Co. Ltd.	Eliminations and Adjustments	Consolidated Balance Sheet
Cash	70,000	205,000	50,000		325,000
Accounts and notes receivable	190,000	285,000	180,000		655,000
Inventories	156,000	95,000	200,000		451,000

Investment: Barto @ cost	450,000			450,000 (1)	
Crown @ cost	285,000			285,000 (2)	
Bonds — Barto	140,000			140,000 (3)	
Loan — Crown		80,000		80,000 (4)	
Fixed assets	350,000	180,000	240,000		770,000
Organization expenses	20,000	8,000	10,000		38,000
Goodwill				3,000$(2)	
				2,000 (1)	1,000$
	1,661,000	853,000	680,000		2,238,000
Accounts and notes payable	375,000	180,000	196,000		751,000
Loan Payable — Barto			80,000	80,000 (4)	
5% bonds payable	400,000	200,000		140,000 (3)	460,000
Capital stock	800,000	440,000	360,000	270,000 (2)	800,000
				440,000 (1)	90,000 M
Earned surplus — @ 31/12/47	40,000	8,000	24,000	18,000 (2)	40,000
				8,000 (1)	6,000 M
for 6 mos. ending 30/6/48	46,000	25,000	20,000		5,000 M
					86,000
	1,661,000	853,000	680,000		2,238,000

$ denotes red figure

(b) **ACME COMPANY LIMITED AND SUBSIDIARIES**

DETAILS OF ELIMINATIONS AND OTHER ADJUSTMENTS

1. Acme purchased 100% Barto @ 31/12/47

100% capital stock of Barto	$440,000		
100% earned surplus @ 31/12/47	8,000		
Book value of investment	448,000		
Cost	450,000		
Therefore goodwill	2,000		
Therefore eliminate from Barto Capital		$440,000	
Eliminate from Barto Surplus		8,000	
Set up consolidated goodwill		2,000	
Eliminate investment in Barto			$450,000

N.B. — One might reduce earned surplus of Barto by reason of organization expenses unamortized.

2. Acme purchased 75% Crown @ 31/12/47

75% capital stock of Crown	$270,000
75% earned surplus @ 31/12/47	18,000
Book value of investment	288,000
Cost	285,000
Therefore excess book value over cost	3,000

Therefore eliminate from Crown capital	270,000	
Eliminate from Crown surplus	18,000	
Write down consolidated goodwill		3,000
Eliminate investment in Crown		285,000
N.B. — One might reduce surplus of Crown by reason of organization expenses unamortized.		
3. Acme purchased $140,000 Barto bonds at par		
Therefore eliminate from investment in bonds — Barto	140,000	
Eliminate from 5% bonds payable		140,000
4. Barto made a loan of $80,000 to Crown		
Therefore eliminate loan to Crown	80,000	
Eliminate loan payable to Barto		80,000

(c)

ACME COMPANY LIMITED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
As at 30 June 1948

ASSETS

Cash	$325,000	
Accounts and notes receivable	655,000	
Inventories	451,000	$1,431,000
Fixed assets		770,000
‡ Organization expenses		37,000
		2,238,000

LIABILITIES AND CAPITAL

Accounts and notes payable		751,000
5% bonds payable		460,000
Minority interest:		
Capital stock	90,000	
Earned surplus	11,000	101,000
Capital and surplus:		
Capital stock	800,000	
Earned surplus	126,000	926,000
		$2,238,000

Contingent liabilities $190,000

‡ Note — Negative goodwill of $1,000 deducted from organization expense of $38,000

PROBLEM 2

Final Examination, November 1948

Accounting IV, Question 5 (15 marks)

The management of The Makum Wet Manufacturing Co. Ltd. is concerned about the adequacy of the depreciation rates which are in use in respect of the factory machinery.

As at 1 Jan 1947 the company had on hand 400 machines. A survey at this time revealed that the information given below in respect of 8 of the machines may be taken as being representative of the 400 machines.

The subsidiary "machinery ledger" is in agreement with the general ledger control account as to the cost of the installed machines. The depreciation reserve account has been accumulated by crediting thereto each year an amount equal to 10% of the balance of the

machinery control account as at the beginning of the year and proceeds from the sale of machines (either as used or scrap) and debiting the account with the cost of all units put out of service.

During 1947 the company purchased 42 machines at a cost of $273,000. An equal number of machines, recorded as having cost $272,100 were retired and the proceeds of salvage of $5,190 were credited to the reserve account. This latter amount approximates the salvage prices received over the past years.

The company manufactures a product for which the demand is relatively stable and as a result there has been no appreciable growth in the size of the plant for a number of years.

The depreciation reserve account as at 31 Dec 1947 amounts to $1,270,000 after crediting the annual provision for depreciation in the amount of $285,000.

Machine	Year Purchased	Estimated Useful Life from 1st Jan. 1947	Cost
1	1938	2 years	$ 8,000
2	1939	4 "	7,000
3	1940	3 "	12,000
4	1941	5 "	1,000
5	1942	7 "	13,000
6	1944	7 "	3,000
7	1945	9 "	4,000
8	1947	10 "	5,000

Required:

a) Schedule showing the calculation of the adequacy or otherwise of the provision.

b) Is the annual depreciation provision adequate in the light of the foregoing circumstances?

A SOLUTION

(a)

THE MAKUM WET MANUFACTURING CO. LTD.

Analysis of Depreciation

as at 31 Dec 1947

Machine No.	Year Purchased	Estimated useful life from 1/1/47	Cost		Depreciation to 1 Jan. 1947	1947 Depreciation based on revised estimate of useful life	Depreciation to 1 Jan. 1947 on basis of total useful life estimate	1947 Depreciation based on total useful life as estimated
1	1938	2	$ 8,000	8	$ 6,400	$ 800	$ 6,400	$ 800
2	1939	4	7,000	7	4,900	525	4,455	636
3	1940	3	12,000	6	7,200	1,600	8,000	1,333
4	1941	5	1,000	5	500	100	500	100
5	1942	7	13,000	4	5,200	1,114	4,727	1,182
6	1944	7	3,000	2	600	343	667	333
7	1945	9	4,000	1	400	400	400	400
			$48,000		$25,200	$4,882	$25,149	$ 4,784

Assumed reserve for 8 machines at 31st December 1947 $\frac{8}{400} \times 1,270,000$ — $25,400

Assumed reserve for 8 machines at 1st January 1947 $\frac{8}{400} \times 1,251,910$ — 25,038

If the depreciation reserve had reached the theoretical point of stability it would remain at one-half of $48,000 less approximately 2% thereof, or at slightly over $23,520. The reserve accumulated to date and the amount that would have been accumulated on the basis of the revised estimates of useful service life are to all practical purposes equal and both are in excess of the theoretical point of stability. It does appear that the accumulated reserve, that is, the $25,400, is greater than it would be if calculated on specific items and in addition is greater than it would be at the stability point.

(b)

The annual provisions at the stability point would be approximately $4,704. The actual provision for the year was $4,800 (10% of opening book balance). This would seem to indicate that the annual provisions are approximately adequate, particularly when reference is made to the total of the last column, $4,784.

It appears that current provisions are slightly more than adequate on the long-run average basis, but that for some reason, perhaps the inability to secure replacement machines as desired, the reserve has accumulated to a level slightly higher than the stability point. The fact that 42 machines were replaced during the year gives added weight to this supposition.

PROBLEM 3

Final Examination, November 1948

Accounting IV, Question 6 (5 marks)

The SAD Co. lost its main store in a fire on 3rd July 1948. The actual value of the property at the time of the fire was $50,000, and the insurance policy contained the following clause: "This company shall not be liable for a greater proportion of any loss or damage to the property described herein than the sum hereby insured bears to eighty per cent (80%) of the actual cash value of said property at the time such loss shall happen, nor for more than the proportion which this policy bears to the total insurance thereon".

Required:

The correct amount of the fire insurance claim that can be collected if:

a) The loss amounted to $40,000, and the insurance carried as at 3rd July 1948 amounted to $45,000.

b) The loss amounted to $25,000 and the insurance carried as at 3rd July 1948 amounted to $40,000.

c) The loss amounted to $20,000 and the insurance carried as at 3rd July 1948 amounted to $25,000.

d) The loss amounted to $45,000 and the insurance carried as at 3rd July 1948 amounted to $25,000.

A SOLUTION

Actual value of property: $50,000

Insurance required: 80% of $50,000 $40,000

a) Loss: $40,000 Insurance: $45,000

Insurance more than required. Loss paid in full: Claim $40,000

b) Loss: $25,000 Insurance: $40,000

Insurance equals that required. Loss paid in full: Claim $25,000

c) Loss: $20,000 Insurance: $25,000

Insurance less than required. Portion of loss paid:

$\frac{25}{40} \times \$20,000$ $12,500

d) Loss: $45,000 Insurance: $25,000	
Insurance less than required. Portion of loss covered. Portion to be paid is greater than amount of policy so that the amount recoverable is the face value of the policy or	$25,000

PROBLEM 3

FINAL EXAMINATION, NOVEMBER 1948

Accounting IV, Question 7 (10 marks)

The trial balance of the Growing City as at 31 Dec 1947 is as follows:

Cash on hand	$ 1,560	
Cash in bank	3,900	
Taxes receivable—1947 levy	94,000	
" " 1946 levy	53,200	
Bank loan		$ 67,000
Accounts receivable—sundry	1,300	
Accounts payable		58,700
Expenses	469,700	
Revenues		484,300
Property	1,854,000	
Bonds payable — 5% due 1st January 1963		800,000
Surplus as at 1st January 1947		1,067,660
	$2,477,660	$2,477,660

The following additional information is obtained from the records:

(1) The 1947 tax levy amounted to $470,000, all of which was credited to revenue. The 1946 levy amounted to $452,000.

(2) Of the total levy of $470,000, $210,000 was for school purposes and of this amount $198,000 had been paid over to the school board. This payment had been charged to expense. Of the 1946 levy of $452,000, $201,000 was for school purposes, all of which had been paid to the school board.

(3) Past experience has shown that of any one year's levy approximately 4% will not be collected,

(4) During the year two new garbage trucks were purchased at a cost of $6,700 each and the amount was charged to expense.

(5) On 1 Jan 1947 bonds with a face value of $50,000 were redeemed at par in accordance with the terms of the issue.

(6) Interest on the bonds, which is due on 1 Jan and 1 July of each year is recorded when paid.

(7) The figure for accounts payable includes a provision of $4,000 for a new truck for the Works Department. Delivery of this truck was made on 3 Jan 1948. This truck was ordered to replace an old truck, originally costing $2,950, which was sold on 17 Dec 1947. The only entry made on the disposal of the old truck was to credit the proceeds of $350 to revenue and to debit cash. The new truck had been charged to expense since the original truck had been charged to the property account.

(8) Invoices amounting to $3,640 in respect of 1946 transactions had not been set up at the end of 1946 and when paid during 1947 were charged to expense.

Required:

Balance sheet in proper form as at 31 Dec 1947.

A SOLUTION

GROWING CITY

BALANCE SHEET

as at 31 Dec. 1947

Current

ASSETS

Cash on hand			$ 1,560	
Cash in bank			$ 3,900	
Accounts receivable			1,300	
Taxes receivable				
1947 levy	$ 94,000			
1946 levy	53,200	$147,200		
Less: Reserve for non-collection		36,880	110,320	$117,080
Deficit:				
Balance as at 1st January 1947		$ 39,760		
Less: surplus for year		5,740	$ 34,020	
Add: loss on sale of truck			2,600	36,620
				$ 153,700

Capital

Property	$1,864,450
	$1,864,450

LIABILITIES

Current

Accounts payable	$ 54,700
Bank loan	67,000
Due to school board account levy	12,000
Accrued interest payable	20,000
	$ 153,700

Capital

Bonds payable—5% due 1st January 1963	800,000
Revenue contributions to capital—	1,064,450
	$1,864,450

Working Papers (Growing City)

			Adjustments		Capital Account		Current Account	
			Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash on hand	1,560						1,560	
Cash in bank	3,900						3,900	
Taxes receivable—1947 levy	94,000						94,000	
Reserve				1* 18,800				18,800
Taxes receivable—1946 levy	53,200						53,200	
Reserve				2* 18,080				18,080
Bank loan		67,000						67,000
Accounts receivable	1,300						1,300	
Accounts payable		58,700	6* 4,000					54,700
Expenses	469,700		4* 20,000	5* 21,250			249,410	
				3* 13,400				
				6* 4,000				
				9* 3,640				
Revenues		484,300	12* 210,000	10* 198,000				273,950
			7* 350					
Property	1,854,000		3* 13,400	8* 2,600	1,864,450			
				7* 350				
Bonds payable		800,000				800,000		
Surplus as at 1/1/47		1,067,660	5* 21,250					1,024,690
			2* 18,080					
			9* 3,640					
	2,477,660	2,477,660						
Provision for uncollectible taxes			1* 18,800				18,800	
Accrued interest payable				4* 20,000				20,000
Loss on sale of truck			8* 2,600				2,600	
School board account—1947				12* 210,000				12,000
Taxes remitted to school board			10* 198,000					
Revenue contributions to capital						1,064,450	1,064.450	
					1,864,450	1,864,450	1,489,220	1,489,220

* denotes red figure

The Canadian Chartered Accountant

Volume 55

July to December 1949

THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS
10 ADELAIDE STREET EAST TORONTO 1, ONT.

Volume 55

INDEX

TOPICS PAGE

CONTRIBUTORS

PUBLICATIONS
of
THE DOMINION ASSOCIATION OF CHARTERED ACCOUNTANTS

The Canadian Chartered Accountant
and
The Tax Review
(*Published monthly*)
$5.00 a year
Permanent Binder for The Tax Review $3.00

Brochures

Audit Procedure for the Junior Audit Clerk (3rd Edition, Feb. 1949) 140 pp.	1.00
Budgetary Control E. S. La Rose (1947) 51 pp.	.50
Stockbrokers' Accounts (June 1940) 31 pp.	.25
Grain Accounts Articles by W. W. McVey, D. A. B. Murray, J. Doctor, W. Aitken, G. G. James (1935) 103 pp.	1.00
Principles of Bookkeeping J. R. M. Wilson (Feb. 1944) 21 pp.	.25

Examination Papers

December 1945 Intermediate and Final	.35
December 1946 Intermediate and Final	.35
December 1947 Intermediate and Final	.35
November 1948 Intermediate and Final	.35

Examination Problems and Solutions

Volume VI, 68 pp.	.50
Volume VII, 76 pp.	.50
Volume VIII, 68 pp.	.50

Accounting and Auditing Research Bulletins

No. 1	A Statement of Standards of Disclosure in Annual Financial Statements of Manufacturing and Mercantile Companies (available in French and English)	.10
No. 2	A Statement of the Minimum Standards of Professional Practice Which should Apply in Respect of Prospectuses (available in French and English)	.10
No. 3	The Accounting Treatment of Income Taxes in Some Special Circumstances (available in French and English)	.10
Binding Folder for Research Bulletins		.15

The Dominion Association of Chartered Accountants

10 Adelaide Street East — Toronto, Ont.